MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Revenue Recognition Team (B. Wilson, ext. 275)
Subject:	Minutes of the December 18, 2002 Board meeting
Date:	January 3, 2003
Code:	A: RR
cc:	Leisenring, Bielstein, T. Johnson, Smith, Petrone, MacDonald, Mahoney, Swift, Polley, Thompson, Gabriele, Sutay, Patton (GASB), Slayton, Such, Manders, B. Wilson, Cohen, Lapolla, Intranet

<u>Topic:</u>	Revenue Recognition — Recognition and Measurement Issues Related to Obligations to Customers that are Performed by Others
<u>Basis for Discussion:</u>	Memorandums dated December 5, 2002 and December 13, 2002
<u>Length of Discussion:</u>	9:00 a.m. to 10:20 a.m.

<u>Attendance:</u>

Board members present:	FASB: Herz, Crooch, Foster, Trott, Schieneman, Schipper, and Wulff
Board members absent:	None
Staff in charge of topic:	T. Johnson, Slayton
Other staff at Board table:	Bielstein, Such, Manders, B. Wilson
Outside participants:	IASB: J. Paul (by phone)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board continued its discussions of the conceptual guidance underlying revenue recognition. The Board discussed cases involving issues related to revenue recognized in conjunction with obligations to customers that are performed by others and EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent." The Board reached the following decisions:

- A reporting entity should not recognize revenues for the performance by third parties of its obligations to deliver goods or render services to its customers if those obligations are legally assumed by those parties.
- A reporting entity should initially measure its obligations for performance guarantees at their fair value and should recognize revenue from the satisfaction or expiration of those guarantees.

The Board directed the staff to explore further (1) issues related to whether a reporting entity should recognize revenues for the performance by a third party of its obligations to deliver goods or render services if those obligations are not legally assumed by that party and (2) whether the working definition of revenues should be refined to incorporate the notions of revenue-generating activities and the performance of those activities.

DISCUSSION

Mr. Johnson began the discussion by noting that at the Board meeting on November 13, 2002 the Board considered a series of cases extracted from EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." In the cases that were discussed at that meeting, the reporting entity itself performed all of its obligations to its customers. In contrast, the cases for this meeting considered whether the reporting entity should recognize revenues with respect to the performance of those obligations if a third party performs them. The cases for this meeting considered both when a third party legally assumes the obligation to perform and when it does not or cannot legally assume the obligations. The cases for this meeting also considered issues addressed in EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent."

Focusing on Memorandum 1 of 2, Mr. Johnson explained that the assets and liabilities approach may not necessarily resolve the issues that arose in the cases identified for this Board meeting. However, he noted that the assets and liabilities approach arises out of the revenues definition in Concepts Statement 6, which defines revenue in terms of changes in assets and liabilities. That definition also indicates that those changes result from the entity's performance of revenue-generating activities. Therefore, the staff recommended that the working definition of revenues be refined to incorporate the notions of revenue-generating activities and the entity's performance of those activities. Furthermore, a reporting entity should recognize revenues only with respect to the activities it performs itself and should not recognize revenues for the performance by other entities of activities that satisfy obligations to its customers.

Mr. Trott stated that he prefers to recognize revenue when the obligation to the customer is satisfied, and that it is important to consider who is primarily obligated in a transaction. He believes that the staff's approach for transactions where a third party does not legally assume the obligations is an activity-based approach as contrasted to a risk-based approach (meaning which entity has the obligation of performance or risk of nonperformance to the customer). He indicated that in circumstances where the customer has not agreed to the transfer of risk, there is no trigger for relief of an obligation. Mr. Trott's inclination is towards a risk-based approach to revenue recognition under these circumstances.

Mr. Foster indicated that he believes that the notion of who is at risk for the activities is very important. He explained that he views a risk-based approach to be similar to an activity-based approach in that the risks may be useful in defining the activities.

Mr. Wulff indicated that he concurs with the staff's recommended approach of activity-based revenue recognition. He added that the project needs to consider: (1) what constitutes performance, (2) what constitutes a revenue-generating activity, (3) what constitutes legal assumption, (4) feasibility of valuation for performance guarantees, and (5) the overall operationality of such an approach.

Mr. Schieneman indicated that he concurs with the activity-based approach, but expressed concern over the operationality of the approach. He also expressed concern whether such an approach improves the predictive value of the financial statements.

Ms. Schipper noted that subcontracting versus performing activities in-house are economically distinct activities. Therefore, the staff's recommended approach could result in separating revenue streams that have different economic and risk profiles. She also noted that the Concept Statements do not currently refer to the bearing of risk of outcome in the definitions of the elements of the financial statements. Ms. Schipper further indicated that the staff should consider what effect inventory risk should have on revenue recognition when obligations are performed by a third party.

In response to Ms. Schipper's comments, Mr. Foster indicated that the notion of inventory risk and the relationship to revenue recognition on sub-assemblies needs to be considered further.

The Board agreed that a reporting entity should not recognize revenues for the performance by third parties of its obligations to deliver goods or render services to its customers if those obligations are legally assumed by those third parties. The Board directed the staff to consider further the issues raised during the discussion related to whether a reporting entity should recognize revenues for the performance by a third party of its obligations to deliver goods or render services if those obligations are not legally assumed by that third party.

The Board agreed that a reporting entity should initially measure its obligations for performance guarantees at their fair value, and should recognize revenue from the satisfaction or expiration of those guarantees. The Board also directed the staff to continue exploring whether the working definition of revenues should be refined to incorporate the notions of revenue-generating activities and the performance of those activities.

The Board did not discuss Memorandum 2 of 2 because it mainly applied the recommendation guidance in Memorandum 1 of 2.

OTHER TOPICS OF DISCUSSION

None

GENERAL ANNOUNCEMENTS

None

SUMMARY FOR ACTION ALERT

See MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION